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No. 79-1266

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

CHARLES W. STEADMAN,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF FOR PETITIONER

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QUESTION PRESENTED

Whether, in SEC disciplinary proceedings involving alleged violations of the anti-fraud provisions of the securities laws, the Commission's findings of violation must be supported by clear and convincing proof, rather than by a mere preponderance of the evidence.

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BRIEF FOR PETITIONER

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit, reported at 603 F.2d 1126, is reproduced at pages 1-34 of the appendix to the petition for certiorari. The opinion of the Securities and Exchange Commission, reported at 12 SEC Docket 1041, is reproduced in the supplemental appendix to the petition for certiorari.

JURISDICTION

The judgment of the court of appeals was entered October 4, 1979. Pet. App. 35. Respondent's petition for rehearing,

filed October 17, 1979, was denied by the court on November 27, 1979. Pet. App. 36. A petition for certiorari, filed within 90 days of the denial of the petition for rehearing, was granted by this Court on April 28, 1980. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

STATUTES INVOLVED

Section 9(b) of the Investment Company Act of 1940, 15 U.S.C. § 80a-9(b), and Section 203(e) and (f) of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-3(e) and (f), are reproduced in an appendix to this brief.

STATEMENT

Petitioner is president, chairman of the board and owner of all the voting stock of Steadman Security Corporation ("SSC"), an investment adviser registered with the Securities and Exchange Commission. SSC advises and manages several mutual funds known as the Steadman Funds.

In 1971, the SEC commenced disciplinary proceedings against Steadman and SSC, pursuant to Section 9(b) of the Investment Company Act of 1940, 15 U.S.C. § 80a-9(b), and Section 203(f) of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-3(f). At the hearing before an Administrative Law Judge, evidence was presented that Steadman and SSC had obtained commercial loans from several banks of national reputation that were custodians for some of the Steadman Funds. The Commission staff maintained that these loans had not been fully revealed to the Funds' directors or mentioned in the prospectuses. Pet. App. 3-5.[1] Petitioner demonstrated by uncontradicted evidence that the mutual funds had not been harmed by these loans, and had, in fact, benefited substantially

[1] The SSC loans had been fully revealed to and approved by the SSC Board of Directors, which included directors of each of the Funds. *See, e.g.*, Exhibits 5A, 6 and 7.

from the placement of the custodial accounts because of the unusually low custodial fees charged by these banks. The evidence also confirmed that Steadman and SSC were accorded no special consideration by the banks; the loans, secured by collateral, bore normal, competitive interest rates and were awarded solely on the basis of the borrower's ability to repay.[2] There were no allegations of commingling or misappropriation of Fund assets.

While generally finding against petitioner, the Commission specifically refused to find that the banks had granted the loans as a quid pro quo for the mutual fund accounts, or that Steadman or SSC had compromised the Funds' interests in managing the accounts. Pet. App. 6. The Commission held, however, that the existence of the loan "relationships" was material information that Steadman and SSC had a duty to reveal to the Funds' investors, and that failure to do so constituted a violation of the securities laws. The Commission's finding was based on the theory that Steadman's and SSC's loans had created the *potential* for maintaining excessive amounts of the Funds' resources in non-interest bearing checking accounts. However, the Commission's Division of Enforcement never alleged that the checking account balances were excessive, and the Commission did not make such a finding. Pet. Supp. App. 27-28 & n.8. *See also* Pet. App. 6. The Commission found that Steadman's violations had been willful. Pet. Supp. App. 34-35. In making its findings, the Commission applied the preponderance of the evidence standard of proof. *Id.* at 14, 96-97 n.88.

The Commission recognized that this was a case of first impression, noting that "no previous litigated case to come before us involved collateral banking relationships of this

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[2] The custodians of the accounts had been determined by the unanimous decisions of non-interested directors of each of the Funds. These directors were persons of reputation and distinction. See Br. for Petr., filed in Fifth Circuit, April 19, 1978, at 30 n.***.

type." *Id.* at 95 n.87.[3] Nevertheless, the SEC imposed upon Steadman the most severe sanctions at its disposal. Pet. App. 28-34.[4] These sanctions would permanently bar Steadman from associating with any investment adviser or becoming affiliated with any registered investment company, and would suspend him for one year from associating with any broker-dealer. In addition, the SEC's order would compel a distress sale of Steadman's principal asset, his stock in SSC, at a substantial loss. These extraordinary sanctions would thus cause petitioner serious financial damage and end his career as an investment adviser.

Although petitioner argued below that the SEC was required to prove the alleged violations by clear and convincing evidence, the United States Court of Appeals for the Fifth Circuit held that the violations required proof only by a preponderance of the evidence. The Fifth Circuit determined that respondents in SEC proceedings are adequately protected by the courts' power "to set aside Commission orders [of sanctions] that are arbitrary and capricious." Pet. App. 27. By relying on appellate review of SEC sanctions to protect the individual, rather than on the standard of proof in the fact-finding process, the court below rejected *Collins Securities Corp.* v. *SEC*, 562 F.2d 820 (D.C. Cir. 1977), and *Whitney* v. *SEC*, 604 F.2d 676 (D.C. Cir. 1979), each of which held that the clear and convincing standard of proof must be applied in

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[3] The Commission also found by a preponderance of the evidence that petitioner had participated as an aider and abettor in the following minor technical violations:

(a) SSC's collection of advisory fees in excess of those specified in the management contract;

(b) SSC's subsidiary's collection of tender solicitation fees to which it was not entitled; and

(c) SSC's failure to comply with certain reporting provisions.

Pet. App. 2 n.1.

[4] No sanctions were ordered against SSC or its subsidiaries; they are not parties to this action.

SEC disciplinary proceedings involving allegations of fraud and the possibility of serious sanctions.[5] The Fifth Circuit remanded, directing the Commission to "articulate a sufficient justification" for its order, which imposed the most severe sanctions at its disposal — total and permanent exclusion of petitioner from the investment advisory industry. Pet. App. 30.

The SEC's petition for rehearing was denied by the court below on November 27, 1979. Pet. App. 36. This Court granted certiorari on April 28, 1980.[6]

SUMMARY OF ARGUMENT

The Securities and Exchange Commission entered an order that would permanently bar petitioner from practicing his profession and force immediate divestiture of his investment advisory business, resulting in enormous financial loss. The question presented is whether the agency can inflict such grievous harm based upon facts satisfying only the preponderance of the evidence standard of proof, a standard characterized as the "rock bottom at the factfinding level of civil litigation." *Charlton* v. *FTC*, 543 F.2d 903, 907 (D.C. Cir. 1976).[7]

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[5] The SEC's petition for rehearing in *Collins* was denied by the court. Instead, in response to the SEC's petition, the D.C. Circuit issued a per curiam order amending and strengthening its opinion. *See* Order of Sept. 25, 1977, Collins Securities Corp. v. SEC, No. 75-2200 (D.C. Cir.).

[6] On June 2, 1980, the Court entered an order granting petitioner's motion to dispense with printing of an appendix.

[7] The preponderance of the evidence standard does not require the trier of facts to feel assured of the correctness of his findings, but only to weigh the probabilities. Thus, to make a finding under that standard, the trier of facts only "must believe that it is more probable that the facts are true or exist than it is that they are false or do not exist." McBaine, Burden of Proof: Degrees of Belief, 32 Calif. L. Rev. 242, 261 (1944) (hereinafter cited as McBaine).

The right to practice one's profession has been recognized as a fundamental aspect of personal liberty that may not be abridged without due process of law. Under principles established by this Court, a government agency may not deprive an individual of that right without ascertaining the facts to a greater certainty, such as that assured by the clear and convincing standard of proof.[8]

In this case an additional factor supports a more demanding standard of proof: the sanctions imposed upon petitioner were based upon a finding that he had committed securities fraud. Courts, including this Court, traditionally have recognized that fraud must be proved by clear and convincing evidence. A higher standard is required because, as demonstrated by the proceedings below, such findings are frequently based upon conjecture or inference and leave a lasting stigma on the individual by tarnishing his reputation. *Addington* v. *Texas,* 441 U.S. 418, 424 (1979).

No policy justifies the relaxed standard of proof embraced by the Commission. In a series of cases since the D.C. Circuit's decision in *Collins Securities Corp.* v. *SEC,* 562 F.2d 820 (D.C. Cir. 1977), the Commission has applied the more demanding clear and convincing standard without any apparent harm to its enforcement processes. On the other hand, SEC disciplinary sanctions result in grievous loss and stigma for the individual upon whom they are imposed. By selecting disciplinary

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[8] The clear and convincing proof standard is significantly more demanding than the preponderance standard. Under the clear and convincing standard, the trier of facts

> must believe that it is highly probable that the facts are true or exist; while it is not necessary to believe to the point of almost certainty, or beyond a reasonable doubt that they are true or exist, or that they certainly are true or exist; yet it is not sufficient to believe that it is merely more probable that they are true or exist than it is that they are false or do not exist.

McBaine, 32 Calif. L. Rev. at 262-63.

sanctions from its large arsenal of enforcement weapons, rather than seeking traditional remedial measures such as injunctive relief, the SEC demonstrates a desire to punish the alleged wrongdoer, not merely to protect the public. Procedural safeguards in administrative punishment cannot be sacrificed based on a mere ritual recitation of the public good.

This Court and other federal courts have consistently applied heavier standards of proof where the proceedings in question involve the possibility of severe harm to the individual and/or findings based on inference or conjecture. Moreover, imposition of the clear and convincing standard of proof in this case accords with congressional intent. The more demanding standard also accords with the great weight of authority holding that disciplinary sanctions against attorneys and other professionals require proof by clear and convincing evidence.

ARGUMENT

I.

THE CLEAR AND CONVINCING STANDARD OF PROOF MUST BE IMPOSED BECAUSE SEC DISCIPLINARY PROCEEDINGS INVOLVE THE RISK OF GRIEVOUS HARM TO THE INDIVIDUAL

As this Court has noted, "the possibility of mistaken factfinding [is] inherent in all litigation." *Speiser* v. *Randall,* 357 U.S. 513, 526 (1958). In the light of this unavoidable uncertainty, the standard of proof "serves to allocate the risk of error between the litigants and to indicate the relative importance attached to the ultimate decision." *Addington* v. *Texas,* 441 U.S. at 423. Rejecting the preponderance of the evidence standard of proof for civil commitment proceedings, *Addington* held that "[t]he individual should not be asked to share equally with society the risk of error when the possible injury to

the individual is significantly greater than any possible harm to the state." *Id.* at 427. These observations are fully applicable here. The SEC itself acknowledged the staggering consequences of an erroneous decision, characterizing the sanctions imposed on petitioner as "drastic."[9] On the other hand, the SEC's interest in imposing disciplinary sanctions is significantly smaller because it has at its disposal a number of alternative methods of protecting investors. *See* pp. 10-11, *infra.* In these circumstances, the more demanding standard of proof is clearly warranted.

Since its earliest decisions, this Court has consistently held that the right to pursue one's chosen occupation is a fundamental personal freedom guaranteed by the Constitution that cannot be denied by the Government without due process. *See, e.g., Yick Wo* v. *Hopkins,* 118 U.S. 356, 374 (1886); *Truax* v. *Raich,* 239 U.S. 33, 44 (1915); *Hampton* v. *Mow Sun Wong,* 426 U.S. 88, 102 n.23 (1976). Moreover, the Court has long recognized that "exclusion from any of the professions or any of the ordinary avocations of life for past conduct can be regarded in no other light than as punishment for such conduct." *Ex parte Garland,* 71 U.S. (4 Wall.) 333, 377 (1866). *Accord, In re Ruffalo,* 390 U.S. 544, 550 (1968). Thus, the sanction imposed upon petitioner by the SEC — permanent exclusion from his profession — is nothing less than drastic punishment. In addition, the SEC's order will result in staggering financial losses for petitioner, as it requires a forced sale of his investment advisory business.

The court below held that clear and convincing proof was not required to justify these severe sanctions, noting that such a standard might impair the Commission's ability to police the securities industry. Pet. App. 26. Yet there is compelling evidence that the heavier standard of proof in disciplinary proceedings does not significantly diminish the Commission's power to deal with securities fraud and other misconduct. Since the D.C. Circuit's decision in *Collins Securities Corp.* v. *SEC,*

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[9] SEC Stay Order of July 14, 1977.

562 F.2d 820 (D.C. Cir. 1977), respondents in twenty disciplinary proceedings before the SEC have asserted that clear and convincing proof is required before the SEC may find violations of the securities laws. In *every one* of these cases, the Commission applied the clear and convincing standard, and found the violation supported by such proof.[10] With regard to

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[10] In re Sartain, Securities Exchange Act Release No. 13,815 (Feb. 8, 1980); In re Blumenfeld, Securities Exchange Act Release No. 16,437, Fed. Sec. L. Rep. (CCH) ¶ 82,396 (Dec. 19, 1979); In re Mansfield, Securities Exchange Act Release No. 16,330 (Nov. 8, 1979); In re D.M.R. Securities, Inc., Securities Exchange Act Release No. 16,322 (Nov. 6, 1979); In re Hodgin, Securities Exchange Act Release No. 16,225, Fed. Sec. L. Rep. (CCH) ¶ 82,334 (Sept. 27, 1979); In re Podesta, Securities Exchange Act Release No. 16,209 (Sept. 18, 1979); In re Nickolaou, Securities Exchange Act Release No. 16,210 (Sept. 18, 1979); In re Seation, Securities Exchange Act Release No. 16,207 (Sept. 17, 1979); In re J.A.B. Securities Co., Securities Exchange Act Release No. 15,948 (June 25, 1979); In re West, Securities Exchange Act Release No. 15,454 (Jan. 2, 1979); In re Nassar & Co., Securities Exchange Act Release No. 15,347, Fed. Sec. L. Rep. (CCH) ¶ 81,904 (Nov. 22, 1978); In re Hinkle Northwest, Inc., Securities Exchange Act Release No. 15,338, 16 SEC Docket 173 (Nov. 16, 1978); In re Schultz, Securities Exchange Act Release No. 15,100 (Aug. 28, 1978); In re Lechman, Securities Exchange Act Release No. 15,101 (Aug. 28, 1978); In re Ernst & Ernst, Accounting Series Release No. 248 (May 31, 1978); In re Investors Research Corp., Investment Advisers Act Release No. 627, Investment Company Act Release No. 10,223, Securities Exchange Act Release No. 14,721, Fed. Sec. L. Rep. (CCH) ¶ 81,586 (May 1, 1978), *aff'd*, No. 78-1589 (D.C. Cir. April 29, 1980); In re Chatham, Securities Exchange Act Release No. 14,594 (March 23, 1978), *aff'd*, 604 F.2d 1368 (D.C. Cir. 1978); In re Douglass & Co., Securities Exchange Act Release No. 14,596 (March 23, 1978); In re International Research & Management Corp., Investment Advisers Act Release No. 617, Investment Company Act Release No. 10,151, Fed. Sec. L. Rep. (CCH) ¶ 81,547 (March 6, 1978), *aff'd*, 588 F.2d 821 (3d Cir. 1978); In re Whitney, Securities Exchange Act Release No. 14,468, (Feb. 14, 1978), *vacated and remanded*, 604 F.2d 676 (D.C. Cir. 1979) (evidence "contradictory and ambiguous"; findings "wholly unsupportable"); and In re Shaw, Hooker & Co., Securities Exchange Act Release No. 14,289 (Dec. 19, 1977).

the clear and convincing standard, there is thus no foundation for the Fifth Circuit's assertion that "[i]f the burden of proof imposed on the Commission is too high, its ability to police the industry is impaired." Pet. App. 26. At the same time, it is established that "standards of proof are important for their symbolic meaning as well as for their practical effect." *Addington* v. *Texas,* 441 U.S. at 426. While not affecting the Commission's overall functions, the heavier standard serves to "impress the factfinder with the importance of the decision and thereby perhaps reduce the chances that inappropriate" sanctions will be imposed. *Id.* at 427. Such caution is particularly appropriate where, as here, "the government is threatening to deprive a person of a way of life to which he has devoted years of preparation and on which he and his family have come to rely." Friendly, *Some Kind of Hearing,* 123 U. Pa. L. Rev. 1267, 1297 (1975) (footnote omitted).

To be sure, the SEC is charged with the responsibility of protecting the investing public from deceptive or fraudulent practices on the part of investment advisers. But, as this Court recently noted, Congress provided the Commission with "an arsenal of flexible enforcement powers" to carry out its mission. *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 195 (1976). Importantly, the SEC has wide investigatory authority, and it may seek an injunction in federal court where it has reason to believe that securities violations are about to take place.[11] In addition, the Commission has sought and obtained orders granting far-reaching ancillary relief, greatly enhancing its

[11] Compared to the "mild prophylactic" of an injunction, the sanctions imposed below are extraordinarily severe. SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 193 (1963). Significantly, during the ten years that this matter has been pending, the SEC has not sought an injunction to limit the activities of SSC or Steadman, undermining its contention that debarment is "in the public interest."

remedial function.[12] Moreover, the Commission is expressly empowered to publish information concerning any violations it uncovers, 15 U.S.C. § 78u(a), information that can form the basis of civil actions by injured investors. The SEC has used these and other powers vigorously. *See* Mathews, *Litigation and Settlement of SEC Administrative Enforcement Proceedings,* 29 Cath. U. L. Rev. 215, 221-29 (1980)(hereinafter cited as Mathews).

Thus, the power to discipline investment advisers is simply one of an awesome array of weapons that the SEC has at its disposal. It is a weapon that imposes severe harm upon the individual without vindicating any investor's interest.[13] Here, then, "one party has at stake an interest of transcending value" and the "margin of error [should be] reduced as to him by the process of placing on the other party the burden . . . of persuading the factfinder . . . of his guilt" by a heavier standard of proof. *Speiser* v. *Randall,* 357 U.S. at 525-26; *Addington* v. *Texas,* 441 U.S. at 427.

In contrast to the Fifth Circuit below, the District of Columbia Circuit has squarely held that the Commission must apply the clear and convincing standard of proof in disciplinary

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[12] Such orders have included the appointment of receivers, the large-scale rescission of completed transactions, the imposition of restrictions on business transactions, the requirement of continuing financial reporting beyond that established by the acts, the appointment of special professionals to oversee company dealings, and the reorganization of the management structures and procedures of business and financial enterprises involved in securities laws violations.

Farrand, Ancillary Remedies in SEC Civil Enforcement Suits, 89 Harv. L. Rev. 1779, 1779 (1976).

[13] "SEC sanctions take the form of deprivations. Deterrence, their purpose, is difficult to measure." Case Comment, 93 Harv. L. Rev. 1845, 1856 n.88 (1980). In any case, deterrence is not an appropriate function of SEC disciplinary proceedings. *See* Beck v. SEC, 430 F.2d 673, 675 (6th Cir. 1970).

proceedings. In *Collins Securities Corp.* v. *SEC*, 562 F.2d 820 (D.C. Cir. 1977), the court carefully examined the Commission's contention that the preponderance standard is sufficient because of the "remedial" nature of the proceedings. Noting that "[s]uch labels are likely to reflect conclusions rather than analyses," the court rejected the distinction between "remedial" and "punitive" proceedings as "not determinative." *Id.* at 825.[14] The District of Columbia Circuit, which reviews more disciplinary orders than any other court, found that imposition of the clear and convincing standard of proof in SEC disciplinary proceedings will not impair the Commission's mission of protecting the public "for [the standard] will be used by the agency which is specially charged with such protection, and is able to make an informed appraisal of the significance of evidence concerning securities and markets." *Id.* at 826. Indeed, this observation has been fully borne out by the SEC's post-*Collins* decisions. *See* p. 9 & n.10, *supra*.

The *Collins* court further recognized that "[t]he standard of proof to which the agency is held must in some substantial measure be commensurate with . . . the arsenal of sanctions available to the agency," and concluded that imposition of the clear and co..vincing standard "serves this function of drawing a realistic correlation between the burden of persuasion and the available remedies." 562 F.2d at 826. In *Whitney* v. *SEC*, 604 F.2d 676 (D.C. Cir. 1979), the court reaffirmed *Collins*, holding that the SEC must apply the heavier standard of proof

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[14] The *Collins* court stated as follows:

> From the point of view of the public and enforcement agency, the action of the SEC is "remedial." To the broker removed from his profession the action partakes of "punitive" impact. One would hardly say that removal of a robber from society should be classed as only "remedial," because it protects ordinary citizens from his probable repetition of the crime.

562 F.2d at 825 (footnotes omitted).

in proceedings resulting in a mere nine-month suspension. *Id.* at 681.[15]

In contrast to the reasoned approach of *Collins* and *Whitney,* the court below failed to recognize that hollow references to the SEC's "remedial" function do not obviate the need for affording procedural protections to individuals subject to serious sanctions. This Court has repeatedly warned against such wooden reliance upon semantic labels. *See, e.g., O'Bannon* v. *Town Court Nursing Center,* 48 U.S.L.W. 4842, 4848 (June 23, 1980) (Blackmun, J., concurring); *Addington* v. *Texas,* 441 U.S. at 426-27; *Califano* v. *Westcott,* 443 U.S. 76, 85 (1979). Thus, simply because a proceeding may be characterized as remedial, it may not be used to inflict any manner of harm on an individual "upon no higher degree of proof than applies in a negligence case." *Woodby* v. *Immigration Service,* 385 U.S. 276, 285 (1966).

The inadequacies of the "preponderance of the evidence" standard of proof cannot be remedied, as the court below suggested, by appellate review of SEC disciplinary orders pursuant to an "arbitrary and capricious" standard of review.[16] The "arbitrary and capricious" standard of review would not

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[15] The nine-month suspension in *Whitney* stands in stark contrast to the permanent professional disqualification and forced divestiture imposed on petitioner by the Commission below.

[16] The Fifth Circuit was troubled by the disproportionate severity of the "harsh sanctions" imposed upon petitioner on the basis of largely technical violations. This disproportion was particularly apparent in light of the Commission's express refusal to find that the Funds' custodial accounts had been placed as an inducement for the loans, the undisputed benefits realized by the Funds from the location of the custodial accounts, and the novelty of the Commission's theory that the mere potential for adverse inferences creates a disclosure obligation notwithstanding the absence of wrongdoing. *See* Pet. App. 30; pp. 2-4, *supra.* The court thus remanded to the SEC with instructions "to articulate carefully the grounds for its decision, including an explanation of why lesser sanctions will not suffice." Pet. App. 34.

reduce the likelihood of erroneous determinations of guilt, for guilt established "upon a bare preponderance of evidence . . . leaves the issue in doubt." *Maxwell Land-Grant Case,* 121 U.S. 325, 381 (1887).[17] In addition, the necessity to explain the sanctions does nothing to mitigate the severe stigma associated with a finding that petitioner engaged in securities fraud. *Addington* v. *Texas,* 441 U.S. at 425-26 (higher standard of proof required due to stigma associated with adverse factual finding). *See In re Winship,* 397 U.S. at 374 (Harlan, J., concurring). *See also* p. 20, *infra.*[18] Thus, the "arbitrary and capricious" standard is not an adequate substitute for clear and convincing proof. For persons stigmatized by a finding of fraud

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[17] Mr. Justice Brennan, writing for the Court in In re Winship, 397 U.S. 358 (1970), noted that the preponderance of the evidence standard may be inherently defective in failing to assure that factual determinations even reflect the weight of the evidence:

> [T]he preponderance test is susceptible to the misinterpretation that it calls on the trier of fact merely to perform an abstract weighing of the evidence in order to determine which side has produced the greater quantum, without regard to its effect in convincing his mind of the truth of the proposition asserted.

Id. at 367-68, *quoting* Dorsen & Rezneck, In re Gault and the Future of Juvenile Law, 1 Family L. Quarterly, No. 4, at 1, 26-27 (1967).

[18] In this case, the inflammatory language employed by the SEC imposed the severest possible stigma upon petitioner. The Commission stated as follows: "So egregiously faithless a fiduciary as Steadman cannot be permitted to meddle further with other people's money." Pet. Supp. App. 99-101 (footnotes omitted). Such vitriolic language is particularly inappropriate in view of the uncontroverted evidence that no one had been harmed by petitioner's conduct and the SEC's refusal to find that petitioner had gained any benefit from the alleged violations. Indeed, the Funds were the only ones to benefit from petitioners' allegedly "faithless" conduct. For example, one Fund's account was transferred in 1970 to the National Bank of Washington. Tr. 809, 811, 1128-40; Exhs. J, K, 251. The NBW had made one substantially collateralized loan to Steadman at competitive interest rates. Tr. 718-19. Since 1970, this Fund has realized almost $500,000 in savings from the transfer.

or punished by an SEC order, it is little comfort to know that, pursuant to the Fifth Circuit's formula, the SEC must carefully frame an explanation for the sanctions it imposes based upon an erroneous determination of guilt.

II.

THE CLEAR AND CONVINCING STANDARD OF PROOF MUST BE IMPOSED FOR THE ADDITIONAL REASON THAT THE SEC DISCIPLINARY PROCEEDINGS AGAINST STEADMAN INVOLVED ALLEGATIONS OF FRAUD

In *Addington,* the Court noted that the clear and convincing standard of proof is applied "in civil cases involving allegations of fraud or some other quasi-criminal wrongdoing by the defendant." 441 U.S. at 424. This requirement is imposed because "[t]he interests at stake in those cases are deemed to be more substantial than mere loss of money," for the defendant risks having his reputation tarnished erroneously. By increasing the plaintiff's burden of proof, the risk of an erroneous determination is reduced. *Id.; Woodby* v. *Immigration Service,* 385 U.S. at 285 n.18. In addition, charges of fraud must frequently be proved by inferences drawn from circumstantial evidence, thus increasing the danger of an erroneous determination and making the higher standard of proof a necessary safeguard. *See Collins Securities Corp.* v. *SEC,* 562 F.2d at 824-26.

SEC disciplinary proceedings are squarely governed by these principles. The charges in such proceedings unquestionably involve "allegations of fraud or . . . quasi-criminal wrongdoing." A determination of securities fraud tarnishes the reputation of the accused and seriously impairs his ability to conduct business even if the Commission does not order debarment. In addition, securities fraud cases, like those involving common law fraud, frequently turn on inference and conjecture, particularly involving the accused's state of mind.

See Aaron v. *SEC*, 48 U.S.L.W. 4609, 4613-15 (June 2, 1980), (scienter required under Section 17(a)(1) of the Securities Act of 1933); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. at 194-214 (scienter required under Section 10(b) of the Securities Exchange Act of 1934). SEC disciplinary proceedings "inevitably are subject, in varying degrees, to the uncertainties of circumstantial and subjective proof, and result in stigmatizing the defendant irrespective of the formal sentence meted out." *Whitney* v. *SEC*, 604 F.2d at 681. *Accord, Collins Securities Corp.* v. *SEC*, 562 F.2d at 824-26.

The Fifth Circuit below considered securities fraud to be so different from common law fraud as to render these considerations inapplicable. Pet. App. 25. That conclusion was based on a single premise: because intent to defraud need not be proved to establish a violation of some sections of the securities laws, "violation[s] of these sections . . . are capable of proof by ordinary direct or circumstantial evidence as in any other administrative proceeding." *Id.* That premise is plainly in error. It is absolutely clear that before the SEC may take any action in a disciplinary proceeding, it must first determine the respondent's mental state, even where scienter is not an element of the substantive offense charged. This is because, under this Court's holding in *Aaron*, the enforcement provisions under which the SEC pursues its remedies "modify the substantive provisions at issue . . . so far as scienter is concerned." 48 U.S.L.W. at 4615. *See also SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 192 n.40 (1963).

Section 9(b) of the Investment Company Act and Section 203(f) of the Investment Advisers Act, 15 U.S.C. §§ 80a-9(b), 80b-3(f), pursuant to which these disciplinary proceedings were brought, augment the substantive statutory provisions by requiring the SEC to make two additional determinations: (1) that the violations were "willful,"[19] and (2) that the imposition

[19] Section 9(b) contains the willfulness requirement in each of its three subsections. Section 203(f) incorporates by reference the willfulness requirement of Section 203(e)(4), 15 U.S.C. 80b-3(e)(4).

of sanctions would be "in the public interest."[20] These determinations require heavy reliance upon inferential and subjective evidence, and are *not,* as the Fifth Circuit suggested, "capable of proof by ordinary direct or circumstantial evidence."

The willfulness requirement, by definition, involves an inquiry into petitioner's mental state. Even under the narrowest interpretation of willfulness, the SEC must determine that the accused intended to perform the acts that constitute the offense, and that they were not merely the product of accident, inadvertence, ordinary carelessness or simple negligence.[21] *See Arthur Lipper Corp.* v. *SEC,* 547 F.2d 171, 180 (2d Cir. 1976), *cert. denied,* 434 U.S. 1009 (1978); L. Loss, *Securities Regulation* 3373 (2d ed. Supp. 1969). However, there is strong indication

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[20] The legislative history of these provisions is quite explicit that the SEC may take disciplinary action only upon making these findings:

> The Commission could take such action *only if it found* (1) that the individual in question had willfully violated, or had willfully participated in a violation of any provision of the Securities Act, the Securities Exchange Act, the Investment Company Act or the Investment Advisers Act or any rule or regulation under those statutes; and (2) that the action was in the public interest.

Report of the House Comm. on Interstate & Foreign Commerce, H.R. Rep. No. 1382, 91st Cong., 2d. Sess. 20 (1970); Report of the Senate Comm. on Banking & Currency, S. Rep. No. 1351, 90th Cong., 2d. Sess. 33 (1968) (emphasis added).

[21] Where, as in this case, the allegedly culpable act consists of an omission, *i.e.,* petitioner's failure to make certain disclosures, this requirement becomes much more than a trivial matter. This is particularly true here for, as the SEC has admitted, the violation turned on a question of first impression. Pet. Supp. App. 95 n.87. Moreover, it is totally illogical to assume that Steadman's violations were willful, for he realized no gains from the placement of the custodial accounts, while the benefits to the Funds and their investors —to whom the disclosures allegedly should have been made— were substantial. *See, e.g.,* p. 14, n.18, *supra.*

that Congress intended the willfulness requirement to connote much more, commanding the SEC to establish actual scienter in meeting its burden of proof in disciplinary proceedings. *See Aaron* v. *SEC*, 48 U.S.L.W. at 4612-14;[22] *Whitney* v. *SEC*, 604 F.2d at 682 n.23. *See also* Mathews, 29 Cath. U. L. Rev. at 238-40.[23] Whether one takes a broad or a narrow view, the willfulness requirement, totally ignored by the court below,

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[22] *Aaron* suggests that each Member of the Court, and even the Commission, believes that Congress employs the term " 'willfully' . . . in the securities laws when it want[s] to specify a prerequisite of knowledge or intent." 48 U.S.L.W. at 4616 (Blackmun, J., dissenting); *id.* at 4614-15 (majority opinion). The Commission equated "willfullness" with "intent", arguing that scienter was not required under Section 17(a)(1) of the 1933 Act because the willfulness requirement had been deleted from an earlier draft of that section: "the deliberate elimination of the language of intent reveals that Congress considered and rejected a scienter requirement under all three clauses of § 17(a)." *Id.* at 4614. In contrast, the operative provisions here involved *include* a willfulness requirement. The same logic employed by the Commission and accepted by this Court in *Aaron* forces the conclusion that the term "willful" in Section 9(b) of the Investment Companies Act and Section 203(f) of the Investment Advisers Act also connotes intent or scienter.

[23] State of mind is particularly relevant where, as here, petitioner was charged, *inter alia*, with aiding and abetting violations allegedly committed by SSC. Pet. App. 2 n.1. The D.C. Circuit recently held that in administrative hearings where sanctions may be imposed, a state of mind amounting to more than mere negligence must be shown to establish aider-and-abettor liability. Investors Research Corp. v. SEC, No. 78-1589 (D.C. Cir., Apr. 29, 1980), slip op. at 17-21. Significantly, the D.C. Circuit relied upon a similar decision in the Fifth Circuit, a decision ignored by the panel below. Woodward v. Metro Bank, 522 F.2d 84, 94-97 (5th Cir. 1975) (aider and abettor must have assisted "knowingly and substantially" in the principal violation). Of course, with regard to SSC's loans, the disclosure obligation, if any, would have rested in the first instance on the corporation and the directors approving the loans.

plainly necessitates an inquiry into the accused's mental state akin to that made in common law fraud actions.[24]

The second requirement in disciplinary proceedings compels the SEC to make additional complex factual determinations. Thus, in deciding what is "in the public interest," the SEC considers a variety of factors, the factual basis of which can be determined only by inference, conjecture and subjective judgment. *See* Thomforde, *Patterns of Disparity in SEC Administrative Sanctioning Practice,* 42 Tenn. L. Rev. 465, 473-74 (1975). Indeed, the SEC itself has taken the position that "the state of mind of the participants" is a major factor in determining what sanctions are "in the public interest."[25] As amply demonstrated by the SEC's opinion in this case, this determination is based largely upon inference and conjecture. Pet. Supp. App. 95-103. *See Beck* v. *SEC,* 430 F.2d 673, 674-75 (6th Cir. 1970).[26] Thus, the Fifth Circuit's unsubstantiated assertion that SEC disciplinary proceedings involve no inferential proof — its only stated basis for refusing to follow the D.C. Circuit's reasoned approach in *Collins* and *Whitney*—does not survive close examination.

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[24] Steadman did not testify in the administrative hearing. Thus, the Commission's findings of willfulness were based on what the Fifth Circuit termed "only the coincidence that Steadman and SSC borrowed from the funds' custodians." Pet. App. 30. Inference and conjecture were therefore inherent in the Commission's reasoning process.

[25] The Fifth Circuit recognized this in its opinion:

> We heartily endorse the Commission's view that while scienter is not required to make out violations of several of the statutory sections involved here, the respondent's state of mind is highly relevant in determining the remedy to impose.

Pet. App. 29.

[26] Moreover, SEC disciplinary proceedings frequently involve a plethora of substantive charges, some of which require a separate showing of scienter. Thus, petitioner was charged, *inter alia,* with violating Sections 10(b) and 17(a)(1), both of which have been held to require scienter.

As this Court recognized in *Addington*, clear and convincing proof has been required in cases involving allegations of fraud because a finding of fraud stigmatizes the defendant, causing him harm beyond mere loss of money. 441 U.S. at 424.[27] The Fifth Circuit dismissed this argument, treating *Addington* as mere dictum. Yet it is quite clear that, like common law fraud, a finding of securities fraud causes enormous harm to the accused, regardless of whether sanctions are actually imposed. *Whitney* v. *SEC*, 604 F.2d at 681. Indeed, courts have expressly held that violations of federal or state securities laws "are contrary to the concept of honesty and good morals" and involve "the stigma of moral turpitude." *In re Hatch*, 10 Cal. 2d 147, 152, 73 P.2d 885, 887 (1937). *Accord, In re Murphy*, 15 Cal. 3d 533, 542 P.2d 12, 125 Cal. Rptr. 276 (1975); *Cincinnati Bar Association* v. *Shott*, 10 Ohio St. 2d 117, 226 N.E.2d 724 (1967). This severe additional harm to persons charged with securities fraud, and the necessity to rely on inferential evidence in establishing the violation, require application of the clear and convincing standard of proof.

III.

IMPOSITION OF THE CLEAR AND CONVINCING STANDARD OF PROOF IN SEC DISCIPLINARY PROCEEDINGS ACCORDS WITH PRECEDENT AND THE INTENT OF CONGRESS

In a series of recent decisions, this Court has sought to protect individuals from unwarranted deprivation of valuable rights by requiring that the proof against them be greater than the "mere preponderance of the evidence." *Addington* v. *Texas*,

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[27] *See, e.g.*, Weininger v. Metropolitan Fire Ins. Co., 359 Ill. 584, 598, 195 N.E. 420, 426 (1935); Bank of Pocahontas v. Ferimer, 161 Va. 37, 41, 170 S.E. 591, 592 (1933); Bowe v. Gage, 127 Wis. 245, 251, 106 N.W. 1074, 1076 (1906). *See also*, Kaplan, Decision Theory and the Factfinding Process, 20 Stan. L. Rev. 1065, 1072 (1968).

441 U.S. at 423. In *Addington* the clear and convincing standard was held applicable in civil commitment proceedings. *See also Mullaney* v. *Wilbur,* 421 U.S. 684 (1975) (beyond a reasonable doubt standard applicable in criminal proceedings); *Rosenbloom* v. *Metromedia, Inc.,* 403 U.S. 29, 50-52 (1971) (clear and convincing standard applicable in defamation action that implicates First Amendment rights); *In re Winship,* 397 U.S. at 368 (beyond a reasonable doubt standard applicable in proceedings to determine juvenile delinquency); *Woodby* v. *Immigration Service,* 385 U.S. at 285-86 (clear and convincing proof standard applicable in deportation proceedings); *Schneiderman* v. *United States,* 320 U.S. 118, 125 (1943) (clear and convincing proof standard applicable in denaturalization proceedings); *Chaunt* v. *United States,* 364 U.S. 350, 353 (1960) (same). These cases reflect the Court's judgment that where important personal rights are at stake, "[t]he individual should not be asked to share equally with society the risk of error." *Addington,* 441 U.S. at 427.

Petitioner's rights here in jeopardy are indistinguishable from those for which this Court has expressed special solicitude. Petitioner has a constitutionally protected interest in practicing his profession. *See Hampton* v. *Mow Sun Wong,* 426 U.S. 88 (1976); *In re Ruffalo,* 390 U.S. 544 (1968); *Ex parte Wall,* 107 U.S. (17 Otto) 265, 289 (1882); *Kivitz* v. *SEC,* 475 F.2d 956, 962 (D.C. Cir. 1973). He has a separate constitutional interest in his reputation, which this Court has repeatedly recognized as a highly valuable asset. For example, *Michelson* v. *United States,* 335 U.S. 469 (1948), noted that evidence of good character alone may be sufficient to raise a reasonable doubt as to criminal culpability.[28] Moreover, the finding of fraud will

[28] Importantly, the courts of appeals have vigorously applied this principle to SEC disciplinary proceedings, reversing findings of misconduct where the accused was able to point to a previously unblemished reputation and record for handling investors' funds. *See, e.g.,* Klopp v. SEC, 427 F.2d 455 (6th Cir. 1970); Kivitz v. SEC, 475 F.2d 956 (D.C. Cir. 1973). The evidence at the hearing conclusively established petitioner's distinguished and previously unblemished record.

affect petitioner's standing in the community and may impair his ability to obtain other employment. *See* p. 20, *supra. Compare, Bishop* v. *Wood,* 426 U.S. 341, 348 (1976); *Paul* v. *Davis,* 424 U.S. 693, 701 (1976).

The risk of such harm is particularly acute where, as here, the finding is based on "inferences . . . dependent on the exercise of discretion by an administrative agency and not a court." *Collins Securities Corp.* v. *SEC,* 562 F.2d at 823. *See* pp. 17-19, *supra.* [29] Because the agency performs both prosecutorial and adjudicatory functions, it may lack total objectivity. Courts have therefore shown particular concern for procedural safeguards where administrative action results in the impairment of protected interests. *See Environmental Defense Fund, Inc.* v. *Ruckelshaus,* 439 F.2d 584, 597-98 (D.C. Cir. 1971).[30] In a particularly applicable passage, Professor Jaffe noted:

> In situations when individuals stand to suffer serious liabilities as a consequence of administrative action, justice may be served by demanding increased procedural protections. One begins with the fact that *in certain respects administrative procedures are less solicitous of the protections of the individual than are civil or criminal procedures. For this reason it may be appropriate in some cases to impose greater burdens of proof, and/or more thoroughgoing judicial review.*

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[29] This problem is aggravated in this case by the failure of the SEC to promulgate, either informally or by formal rule, substantive standards for disciplinary proceedings or administrative sanctions. *See* Case Comment, 93 Harv. L. Rev. at 1855 & n.82. *See also* Pet. App. 28 n.18.

[30] This Court "repeatedly has emphasized that 'procedural due process rules are shaped by the risk of error inherent in the truth-finding process . . . .' *Mathews* v. *Eldridge,* 424 U.S. 319, 344 (1976)." Carey v. Piphus, 435 U.S. 247, 259 (1978) (footnote omitted).

Jaffe, *Administrative Law: Burden of Proof and Scope of Review,* 79 Harv. L. Rev. 914, 919-20 (1966) (emphasis added).[31]

In gauging the weight of these considerations, it should be noted that Congress has not expressly provided a standard of proof for SEC disciplinary proceedings. Where Congress has not spoken, the federal courts have consistently supplied the standard of proof that is appropriate in light of the interest at stake. *Vance* v. *Terrazas,* 100 S. Ct. 540, 547-48 (1980), citing as an example *Nishikawa* v. *Dulles,* 356 U.S. 129, 135 (1958) (clear and convincing proof required in expatriation proceedings). *See also, e.g., United States* v. *Foster Wheeler Corp.,* 447 F.2d 100, 101 (2d Cir. 1971) (clear and convincing proof required for civil liability under the False Claims Act).

Congressional silence in this instance connotes more, however, than simple deference to this Court's prospective judgment; it constitutes an affirmative intention to ensure the higher standard of proof. The statutory provisions pursuant to which sanctions were imposed were enacted as part of the Investment Company Amendments Act of 1970. Pub. L. 91-547, 84 Stat. 1413. In determining congressional intent, these provisions "must be interpreted in the light of the common law and scheme of jurisprudence existing at the time of [their] enactment." 2A J. Sutherland, *Statutory Construction* § 50.01, at 268 (4th ed. 1973). Two separate lines of common law authority support the application of the clear and convincing standard of

[31] The proceedings in this case underscore these concerns. For example, petitioner argued to the Commission that the Administrative Law Judge's 136 page opinion was in substantial part a duplicate of the brief submitted by the Division of Enforcement. *See* Br. of Resp. in Support of Pet. for Review 90-91 (Mar. 17, 1975). The Commission dismissed this and similar concerns in a scant footnote, terming them "baseless." Pet. Supp. App. 96 n.88. This offhand treatment evidences a disturbing lack of sensitivity to the seriousness of this issue.

proof in SEC disciplinary proceedings. The first consists of cases dealing with the standard of proof applicable to proceedings imposing disciplinary sanctions upon attorneys. The great weight of authority in the state and federal courts holds that such discipline may be imposed only upon a showing of clear and convincing proof. *See, e.g., In re Fisher,* 179 F.2d 361, 369-70 (7th Cir.), *cert. denied,* 340 U.S. 825 (1950) (disbarment); *In re Ryder,* 263 F. Supp. 360, 361 (E.D. Va.) (disbarment), *aff'd,* 381 F.2d 713 (4th Cir. 1967); *In re Pennica,* 36 N.J. 401, 419, 177 A.2d 721, 730 (1962) (disbarment); *Golden* v. *State Bar,* 213 Cal. 237, 247, 2 P.2d 325, 329 (1931).[32]

The second line of authority pertains to cases involving allegations of fraud. As discussed above, the clear and convincing standard of proof "has traditionally been imposed in cases involving allegations of civil fraud." *Woodby* v. *Immigration Service,* 385 U.S. at 285 n.18. *See Saenz* v. *Kenedy,* 178 F.2d 417, 419 (5th Cir. 1949) (fraud "must always be proven by clear and convincing evidence"); 9 J. Wigmore, *Evidence* § 2498, at 329 (3d ed. 1940) (" 'clear and convincing proof' is commonly applied to measure the necessary persuasion for a charge of fraud"). *See also* p. 15, *supra.* More importantly, this and other federal courts have consistently interpreted congressional enactments setting fraud as a standard as importing a requirement of clear and convincing proof. *See, e.g., United States* v. *American Bell Telephone Co.,* 167 U.S. 224, 251 (1897) (action to set aside patent on grounds of fraud); *Maxwell Land-Grant Case,* 121 U.S. 325, 381 (1887) (action to set aside federal land grant on ground that it was issued on

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[32] *See also* In re Berlant, 458 Pa. 439, 441, 328 A.2d 471, 473 (1974) (5 year suspension), *cert. denied,* 421 U.S. 964 (1975); In re Sears, 71 N.J. 175, 197, 364 A.2d 777, 788-89 (1976) (3 year suspension); In re Myrland, 43 Ariz. 126, 128, 29 P.2d 483, 483 (1934); State v. Shumate, 48 W. Va. 359, 364, 37 S.E. 618, 620 (1900); In re Wright, 131 Vt. 473, 489, 310 A.2d 1, 9-10 (1973) & cases cited; In re Gladstone, 28 F. Supp. 858, 860 (S.D.N.Y. 1939).

basis of false representations); *United States* v. *Foster Wheeler Corp.*, 447 F.2d 100, 101 (2d Cir. 1971) (where False Claims Act sets substantive standard of "false, fictitious or fraudulent . . . the law supplies the requirement of clear and convincing proof"); *Lessman* v. *Commissioner*, 327 F.2d 990, 993 (8th Cir. 1964) (in interpreting § 7454(a) of the Internal Revenue Code "[c]ourts have often stated that the Government must establish fraud by clear and convincing evidence").

Congress plainly was aware of these established lines of authority when it enacted the 1970 legislation giving the Commission broad new powers to impose disciplinary sanctions. Had it been dissatisfied with that standard, it would have specified a different one, as it has done on occasion. *See, e.g., Vance* v. *Terrazas*, 100 S. Ct. at 548.[33] Indeed, when Congress has expressly provided a standard of proof, it has been *in derogation* of the standard it knew would be imposed under established common law principles. *See, e.g., Vance* v. *Terrazas, supra; Rogers* v. *Missouri Pacific R.R.*, 352 U.S. 500, 507 (1957) (relaxed evidentiary standard imposed under FELA "because the Congress was dissatisfied with the common law duty of the master to his servant").[34]

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[33] *Terrazas* addressed 8 U.S.C. § 1481 which provides that voluntary acts of expatriation may be proved by a preponderance of the evidence. This Court noted that by articulating a standard in the statute, Congress intended to alter the common law standard of clear and convincing proof for expatriation cases: "its evident aim was to supplant the evidentiary standards prescribed by *Nishikawa.*" 100 S. Ct. at 547. *See* p. 23, *supra.*

[34] Similarly, Congress has raised the standard of proof in circumstances where it has deemed the likely common law standard not sufficiently demanding. Thus, in child custody proceedings and proceedings to terminate parental rights of Indian children, Congress imposed a higher standard than that provided by the common law. *See* Indian Child Welfare Act of 1978, 25 U.S.C. § 1912(e) (clear and convincing evidence standard applicable to custody proceedings);

(footnote continues)

Particularly telling is a series of congressional enactments establishing the standard of proof in quasi-criminal proceedings similar in material respects to the disciplinary proceedings against petitioner. *See, e.g.*, 18 U.S.C. § 4214(d) (parole revocation); 21 U.S.C. § 849 (classification as "dangerous special drug offender" for purposes of sentencing); 41 U.S.C. § 39 (contempt); 50 U.S.C. § 973 (classification as communist action organization). In each instance, Congress reasonably anticipated that, absent congressional direction, federal courts applying common law principles would have imposed a heightened standard of proof.[35] To avoid this, Congress carefully specified in each case that the preponderance of the evidence standard was applicable. Congress' failure to include such a provision in the statute governing SEC disciplinary proceedings raises the strong inference that it expected and intended the courts to incorporate the common law standard requiring clear and convincing proof.

This inference is greatly strengthened by recent developments. Congress has failed to respond to SEC requests that it displace the clear and convincing standard in SEC enforcement proceedings. In July 1979, the SEC filed a memorandum with the Senate Governmental Affairs Committee opposing two regulatory reform bills (S.262 and S.755) unless they were amended to overrule *Collins* by specifically providing a pre-

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(footnote continued)

§ 1912(f) (proof beyond a reasonable doubt standard applicable to parental right termination proceedings). The common law had required only a preponderance of the evidence. *E.g.*, In re S., 26 Or. App. 219, 552 P.2d 578 (1976); In re R.E.W., 545 S.W.2d 573 (Tex. Civ. App. 1976). *See also, e.g.*, 29 U.S.C. § 722(c) (non-eligibility for vocational rehabilitation services must be supported by proof beyond a reasonable doubt).

[35] For example, the common law standard of proof for civil contempt proceedings is "clear and convincing evidence." *E.g.*, Coca-Cola Co. v. Feulner, 7 F. Supp. 364, 365 (S.D. Tex. 1934). To ensure a lower burden in contempt proceedings involving public contract matters, Congress supplanted this standard by explicitly providing for proof "by the preponderance of the evidence." 41 U.S.C. § 39.

ponderance of the evidence standard of proof in all SEC adjudicatory proceedings. *Memorandum of the Securities and Exchange Commission: Hearings on S.262 and S.755 Before the Senate Comm. on Governmental Affairs,* 96th Cong., 1st Sess. 1283, 1325 (1979). Congress has not amended that legislation in response to the SEC's request.

Even more important, within the last year both the House and the Senate have embraced the clear and convincing standard of proof in rules governing hearings of alleged misconduct by their members. *See* House Committee on Standards of Official Conduct, Rules of Procedure, 125 Cong. Rec. H1638, 1640 (daily ed. March 22, 1979); In the Matter of Representation of Representative Charles H. Wilson, 126 Cong. Rec. H4691, 4693-94 (daily ed. June 10, 1980); Senate Select Committee on Ethics, 96th Cong., 2d Sess., Report on Investigation of Senator Herman E. Talmadge 84 (Comm. Print 1980). These hearings are virtually indistinguishable from the disciplinary proceedings below: they generally involve allegations of fraud or other wrongdoing carrying a stigma of moral turpitude; the evidence presented is frequently of an inferential or subjective character; and there is a possibility that serious sanctions, ranging from censure to expulsion, will be imposed. These provisions evidence strong congressional approval of the clear and convincing standard of proof in disciplinary proceedings of the type undertaken against petitioner.

CONCLUSION

As the Court noted in *Addington,* " [i]n cases involving individual rights, whether criminal or civil, '[t]he standard of proof [at a minimum] reflects the value society places on individual liberty.' " 441 U.S. at 425. There can be little doubt that if the Commission's ruling were allowed to stand, it would inflict grievous harm upon petitioner. However, the alleged wrongdoing has been found here by the thinnest margin known to the law. The preponderance of the evidence standard does

not properly reflect the serious burden placed upon petitioner by the risk of erroneous adjudication — a substantial risk here due to the frailty of a reasoning process dependent upon inference and conjecture. Imposition of the higher standard of proof will not affect "the informality, flexibility, or speed of the hearing," *In re Winship,* 397 U.S. at 366; and the Commission has demonstrated that the clear and convincing standard does not hamper its efforts to enforce the securities laws. Requiring clear and convincing proof will simply ensure that before imposing severe sanctions upon petitioner, the SEC be more confident of "the correctness of [its] factual conclusions." *Id.* at 370 (Harlan, J., concurring).

The judgment below should be reversed. The Court should direct the dismissal of all allegations against petitioner in light of the pendency of this action for almost ten years during which time Steadman has been stigmatized and his business dealings have been clouded by the SEC's opinion and order.

Respectfully submitted,

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APPENDIX

Section 9(b) of the Investment Company Act, 15 U.S.C. § 80a-9(b).

(b) The Commission may, after notice and opportunity for hearing, by order prohibit, conditionally or unconditionally, either permanently or for such period of time as it in its discretion shall deem appropriate in the public interest, any person from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter, if such person —

(1) has willfully made or caused to be made in any registration statement, application or report filed with the Commission under this subchapter any statement which was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, or has omitted to state in any such registration statement, application, or report any material fact which was required to be stated therein; or

(2) has willfully violated any provision of the Securities Act of 1933, or of the Securities Exchange Act of 1934, or of subchapter II of this chapter, or of this subchapter, or of any rule or regulation under any of such statutes; or

(3) has willfully aided, abetted, counseled, commanded, induced, or procured the violation by any other person of the Securities Act of 1933, or of the Securities Exchange Act of 1934, or of subchapter II of this chapter, or of this subchapter, or of any rule or regulation under any of such statutes.

Section 203(e) & (f) of the Investment Advisers Act, 15 U.S.C. § 80b-3(e) & (f).

(e) The Commission, by order, shall censure, place limitations on the activities, functions, or operations of, suspend for a period not exceeding twelve months, or revoke the registration of any investment adviser if it finds, on the record after notice and opportunity for hearing, that such censure, placing of limitations, suspension, or revocation is in the public interest and that such investment adviser, or any person associated with such investment adviser, whether prior to or subsequent to becoming so associated —

(1) has willfully made or caused to be made in any application for registration or report required to be filed with the Commission under this subchapter, or in any proceeding before the Commission with respect to registration, any statement which was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, or has omitted to state in any such application or report any material fact which is required to be stated therein.

(2) has been convicted within ten years preceding the filing of any application for registration or at any time thereafter of any felony or misdemeanor which the Commission finds — (A) involves the purchase or sale of any security, the taking of a false oath, the making of a false report, bribery, perjury, burglary, or conspiracy to commit any such offense; (B) arises out of the conduct of the business of a broker, dealer, municipal securities dealer, investment adviser, bank, insurance company, or fiduciary; (C) involves the larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, or misappropriation of funds or securities; or (D) involves the violation of section 152, 1341, 1342, or 1343 or chapter 25 or 47 of title 18.

(3) is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from acting as an investment adviser, underwriter, broker, dealer, or municipal securities dealer, or as an affiliated person or employee of any investment company, bank, or insurance company, or from engaging in or continuing any conduct or practice in connection with any such activity, or in connection with the purchase or sale of any security.

(4) has willfully violated any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, subchapter I of this chapter, this subchapter, or the rules or regulations under any of such statutes or any rule of the Municipal Securities Rulemaking Board, or is unable to comply with any such provision.

(5) has willfully aided, abetted, counseled, commanded, induced, or procured the violation by any other person of any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, subchapter I of this chapter, this subchapter, the rules or regulations under any of such statutes, or the rules of the Municipal Securities Rulemaking Board, or has failed reasonably to supervise, with a view to preventing violations of the provisions of such statutes, rules and regulations, another person who commits such a violation, if such other person is subject to his supervision. For the purposes of this paragraph (5), no person shall be deemed to have failed reasonably to supervise any person, if

(A) there have been established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any such violation by such other persons, and

(B) such person has reasonably discharged the duties and obligations incumbent upon him by reason

of such procedures and system without reasonable cause to believe that such procedures and system were not being complied with.

(6) is subject to an order of the Commission entered pursuant to subsection (f) of this section barring or suspending the right of such person to be associated with an investment adviser which order is in effect with respect to such person.

(f) The Commission, by order, shall censure or place limitations on the activities of any person associated or seeking to become associated with an investment adviser, or suspend for a period not exceeding twelve months or bar any such person from being associated with an investment adviser, if the Commission finds, on the record after notice and opportunity for hearing, that such censure, placing of limitations, suspension, or bar is in the public interest and that such person has committed or omitted any act or omission enumerated in paragraph (1), (4), or (5) of subsection (e) of this section, or has been convicted of any offense specified in paragraph (2) of said subsection (e) within ten years of the commencement of the proceedings under this subsection, or is enjoined from any action, conduct, or practice specified in paragraph (3) of said subsection (e). It shall be unlawful for any person as to whom such an order suspending or barring him from being associated with an investment adviser is in effect willfully to become, or to be, associated with an investment adviser without the consent of the Commission, and it shall be unlawful for any investment adviser to permit such a person to become, or remain, a person associated with him without the consent of the Commission, if such investment adviser knew, or in the exercise of reasonable care, should have known, of such order.